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E.O. 12958: N/A
TAGS: EINV EFIN ETRD ELAB OPIC KTDB USTR PGOV IT
SUBJECT: INVESTMENT CLIMATE STATEMENT 2009 - ITALY

REF: A) 08 STATE 123907

¶1. SUMMARY: Following is Post's submission for 2009 Investment Climate Statement for Italy. End Summary.

OVERVIEW AND UPDATE

¶2. A January 2008 article in London's Financial Times likened investing in Italy to "driving with the brakes on." It cited the dearth of global names and brands in the Italian economy and chronicled the tribulations that have dissuaded firms from AT&T to British Gas from investing in Italy. The author asked rhetorically why there are over 400 Burger Kings in Spain, 500 in the UK, but only 39 in Italy. The conclusion -- that an onerous public sector, unclear rules, and latent economic nationalism were to blame -- tracks with post's assessment of Italy's current investment climate. It is important to note that this negative assessment of Italy's investment climate is shared, in essence, by the Italian Trade Commission, by leading Italian business organizations, and by almost all of the international organizations that have examined the situation (see paras. 14 -16, 44)

¶3. Italy's poor investment climate explains much of its low economic growth rate. Over the last ten years, Italy's economy has grown significantly more slowly than the rest of Europe. Former U.S. Ambassador Spogli saw this "growth gap" as a major threat to Italy's ability to continue as an effective international partner of the U.S. This problem was deemed to be so serious, that the Ambassador took the unusual step of launching a major Embassy initiative - "The Partnership for Growth" in an effort to address it (see para. 17).

¶4. While the current Government of Italy (GOI) officially maintains a welcoming posture to foreign investment, it has made only modest progress in addressing the structural economic disincentives that discourage investment, innovation and greater economic dynamism. The current budget, for example, includes some tax benefits for start-ups and modest measures aimed at reducing red tape for starting businesses.

¶5. Significant stumbling blocks to investment remain, however, such as rigid labor laws, high input costs and taxes, and inefficient public services, particularly a slow judicial system. The current government has sought to reform public administration, prompting protests from public sector employees long accustomed to a lax working pace and environment. The GOI also introduced controversial measures to reform public education in a bid to improve the competitiveness of Italy's human capital. Otherwise, the government's economic team has been engaged primarily in efforts to mitigate the global financial crisis' effects on Italian households and businesses, leaving structural reforms for another day. In the

initial days of the world-wide equity markets' severe declines, Italian policy-makers publicly denounced the prospect of foreign sovereign wealth funds acquiring control of Italian companies (see para. 12), and the government instituted measures to strengthen firms' defenses against hostile takeovers. Finally, Italy's high debt-to-GDP ratio will constrain the government's efforts to further stimulate investment with additional public spending or lower taxes.

INTRODUCTION

¶6. Italy's economy, the seventh largest market economy in the world, is fully diversified. Small and medium-sized firms dominate the Italian economy. Family-owned companies account for 93 percent of all Italian companies and 85 percent of GDP. In the U.S., family-owned companies represent 96 percent of companies, but account for only 40 percent of GDP. Germany, France, and the U.S. remain Italy's most important export markets. Industrial activity is concentrated in the north -- one of the most prosperous areas in Europe. By contrast, the center and the south are less developed. Unemployment in some southern areas is three times that of the north and per capita incomes are substantially lower.

OPENNESS TO FOREIGN INVESTMENT

¶7. Officially, foreign direct investment in Italy is generally welcomed and encouraged. The government of Prime Minister Silvio Berlusconi swept into office aided by general public disgust with the center-left and supported by a northern regional party whose

highest priority is greater fiscal independence from the central government. Despite anemic economic growth most of this decade, voters did not apparently charge Berlusconi with structural reform of the economy that could increase business creation, production and employment.

¶8. The Prodi government presided in 2007 over the contested sale of a controlling stake in Telecom Italia to a consortium of Italian banks and Spain's Telefonica. A U.S. bidder, given the opportunity to put a deal together, withdrew from the competition after intervention from various government political figures made it clear that purchase conditions were liable to change and that a U.S. bidder was viewed unfavorably in many quarters. While Prodi applauded the outcome, the deal prompted U.S. Ambassador Ronald Spogli to publicly call on the Italian government for greater transparency in such transactions and to urge a more welcoming attitude toward investment. He stated specifically:
"As American Ambassador I focus most of all on my country's investments. Here too, the situation is not comforting. Up to 2005 the cumulative total of U.S. investment in Italy amounted to slightly less than $26 billion, well below the U.K. at $324 billion, Germany at $86 billion, France at $61 billion and even Spain at $43 billion. These numbers should provoke reflection. Investments do not come where they are not well received, and where the rules of the market are continually changed. Modifying the rules raises the level of risk, and makes it very difficult to program the future activities of a company, or a single citizen. I do not know the details of the Telecom negotiations, but the renunciation letter of [US Firm] clearly expresses reluctance to invest in a market where the rules are unpredictable."

¶9. The GOI's efforts to sell its 49.9 percent share of Alitalia, the long ailing Italian flag carrier, put the Berlusconi government to an early test on openness to foreign investment and transparency managing the public's money. During the election campaign Berlusconi had declared that the airline should remain Italian, even as Alitalia pursued merger/sale talks with European competitors. Union opposition to those deals and Berlusconi's statements led Air France to withdraw from buy out plans. Once in office, Berlusconi used his personal and political skill to convince a group of Italian businessmen to commit to purchasing the airline and keeping it Italian. He further enticed investors with amendments to the bankruptcy law that permitted Alitalia to split into two companies,

one composed of attractive assets that were transferred to the buyers, and another composed of liabilities to be liquidated by the government and, by extension, the Italian taxpayer. But for this provision, worth hundreds of millions of euros, it is unlikely the deal with Italian investors would have been consummated. To survive, however, the airline still needed an international partner. While the new owners sought to sell a minority stake to Air France/KLM or Lufthansa, Berlusconi repeatedly weighed-in, going so far as to recommend commercial agreements with those carriers rather than offering them even a minority stake in Alitalia. Earlier, under the previous government, an American-led group walked away from its Alitalia bid in the face of an opaque process (to include the firm's financial statements) and labor and political hostility.

¶10. As an EU Member State, Italy is bound by EU treaties and legislation, some of which have an impact on business investment. As specified under the right of establishment set forth in the EU treaty (1957 Treaty of Rome), Italy is obliged to provide national treatment to foreign investors established in Italy or in another EU member state, except in a few instances. Exceptions include limited access to government subsidies for the film industry, added capital requirements for banks domiciled in non-EU member countries, and restrictions on non-EU-based airlines operating domestic routes. Italy also has restrictions in the shipping sector.

¶11. The GOI retains the authority to restrict foreign investment in some cases. EU and Italian anti-trust laws give EU and Italian authorities the right to review mergers and acquisitions over a certain financial threshold. The government may block mergers involving foreign firms for "reasons essential to the national economy" or if the home government of the foreign firm applies discriminatory measures against Italian firms. Foreign investors in the defense or aircraft manufacturing sectors are likely to encounter an opaque process and resistance from the many ministries charged with approving foreign acquisitions of existing assets or firms.

¶12. In the aftermath of the financial crisis' dramatic blow to equity prices worldwide, various Italian policymakers, including Berlusconi, made statements suggesting that Italy would not welcome certain foreign portfolio investments, and in particular those by

sovereign wealth funds. Despite such statements, Italy did not in the end implement any regulation limiting the investment by sovereign wealth funds in Italy; to the contrary, the government hailed minority investments by Middle Eastern sovereign funds such as Libya and Abu Dhabi. In late 2008 Libya's Sovereign fund bought 5 percent of Unicredit, Italy's largest bank, and a stake in ENI, Italy's energy para-statal. Also at the end of 2008, Abu Dhabi's Sovereign Fund bought 3.3 percent of Atlantia, the company that manages Italy's toll-road network. Another Abu Dhabi Fund, Mubadala Development, already controls 5% of Ferrari and 35% of Piaggio Aero Industries.

¶13. Foreign investors are not prevented from investing in the privatization of government-owned companies, except in the defense sector. Privatization strategies often entail the GOI retaining a "golden share" (a government stake with controlling authority) in the company or establishing a core group of Italian shareholders who agree to keep their shares for a minimum period. Italy is the only EU member country to keep significant "golden share" regimes for privatized companies. According to EU data, the Italian government retains special rights in six Italian firms -- ENEL (utilities), ENI (oil/gas), Finmeccanica (industrials), Telecom Italia (telecommunications), Save (Industrials), and Terna (utilities).

¶14. The Italian Trade Commission (ICE) reported in January 2007 that 7,200 foreign companies operate in Italy, employing almost one million workers. According to ICE, the stock of foreign investment in Italy equals 12 percent of GDP, far less than many EU nations. Approximately 77 percent of foreign companies operating in Italy are located in the north, with the Lombardy Region alone hosting 46 percent. The ICE study cited as key obstacles to foreign investment: labor taxes, lack of labor flexibility, red tape, and high corporate taxes. Net direct investment inflows in 2007 were

28.5 billion euros, while net outflows totaled 65 billion euros.

¶15. The World Economic Forum's 2008-2009 Global Competitiveness Guide ranked Italy 49th out of 134 countries with a CG index score of 4.4 on a 1-7 scale. This rank is not as strong as those in previous years, which ranked Italy at 46 in 2007 and 47 in 2006. The report cites as Italy's weak points macroeconomic fragility (related to the level of public debt), an inefficient labor market, lack of infrastructure, and institutional and bureaucratic inefficiency. Italy's strong points are the quality of health care and the primary education system, the diffusion of technologies, and sophisticated management in large and medium Italian companies.

¶16. The 2008 "Index of Economic Freedom," published by the Wall Street Journal and Heritage Foundation, ranked Italy as having the world's 64th freest economy. The study highlighted government interference in the economy, corruption, and a slow court system as contributing to Italy's ranking below less developed nations such as Uganda, Belize, Jamaica and El Salvador. A lack of judicial effectiveness was also underlined by Italy's abysmal ranking of 156 out of 181 countries surveyed by the World Bank in its 2008 edition of "Doing Business." This compares to the average score for OECD members of 33. The Foreign Investors Committee of Italy's industrial association Confindustria conducted a survey of 60 foreign companies operating in Italy, including Coca Cola, GE, Glaxo-SmithKline and others. The results highlighted bureaucracy, costly and inflexible labor, and complex, lengthy legal and taxation systems as the primary barriers to foreign direct investment.

¶17. All the same, Italy can boast of a budding movement, aided and abetted by a US Mission to Italy program called "Partnership for Growth," to foster entrepreneurship among a young, well-educated segment of the population. The movement has served to bring world-class scientific and technological researchers together with venture capitalists and the academic community. The aim of these constituencies is to break the cultural bias against entrepreneurship and seek changes in Italy's policy environment to facilitate business start-ups, growth, and job creation emanating from scientific discoveries.

CONVERSION AND TRANSFER POLICIES

¶18. In accordance with EU directives, Italy has no foreign exchange controls. There are no restrictions on currency transfers, only reporting requirements. Banks are required to report any transaction over 15,000 euros (USD 19,000) due to money laundering and terrorism financing concerns. Profits, transfers, payments, and currency transfers may be freely repatriated. Residents and non-residents may hold foreign exchange accounts.

EXPROPRIATION AND COMPENSATION

¶19. The Italian constitution permits expropriation of private property for "public purposes," defined as essential services or indispensable for the national economy, with fair and timely compensation. There are a few long-standing disputes in Italy involving U.S. citizens who assert that municipal governments unjustly expropriated their real property or inadequately compensated them. These disputes do not reflect systematic GOI discrimination against U.S. investments, but highlight how Italy's ineffective judicial process can hinder investment.

DISPUTE SETTLEMENT

¶20. Though notoriously slow (civil trials average seven years in length), the Italian legal system meets generally recognized principles of international law, with provisions for enforcing property and contractual rights. Italy has a written and

consistently applied commercial and bankruptcy law. While the Italian judiciary is considered independent of the government, Italian judges have often been accused of being politically partisan. Italian courts accept and enforce foreign judgments only upon request. Foreign investors in Italy can choose among different means of dispute resolution, including legally binding arbitration. The method chosen should be specifically set forth in a contract between commercial partners.

¶21. At the end 2007, the GOI approved new bankruptcy regulations which went into effect on January 1, 2008. The new regulations -- analogous to U.S. Chapter 11 restructuring -- provide more flexibility between parties to reach a solution before declaring bankruptcy. The judicial role in bankruptcy procedures has been drastically limited to simplify and speed up the process. The new regulations change the requirements for declaring a company insolvent and they encourage corporate reorganization or debt restructuring as an alternative to liquidation.

¶22. Italy is a member of the World Bank's International Center for the Settlement of Investment Disputes (ICSID). Italy has signed and ratified the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, and is a signatory of the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards.

PERFORMANCE REQUIREMENTS/INCENTIVES

¶23. The GOI is in compliance with WTO Trade-Related Investment Measures (TRIMS) obligations. Foreign investors face specific performance requirements only in the telecommunications sector. However, this has not deterred foreign investment in telecommunications. For example, in 2005, Weather Investments, owned by an Egyptian financier, bought Wind, Italy's second largest telecommunications company; Vodafone, Italy's second largest mobile operator, is also foreign-controlled. Spain's Telefonica is a significant investor in Telecom Italia, having purchased a stake from the GOI in a process that prompted a U.S. firm to withdraw. (see para.8) .

¶24. The GOI offers modest incentives to encourage private sector investment in economically depressed regions, particularly southern Italy. (For more details, visit the website: www.invitalia.it) The Ministry of Universities and Research has identified, funded, and signed Framework Program Agreements with eleven "Technology Districts" and public-private joint laboratories focused on strategic sectors. Technology Districts created to facilitate cooperation between public and private researchers and venture capitalists, support the research and development of key technologies, strengthen industrial research activities, and promote innovative behavior in small- and medium-sized enterprises.

¶25. The Italian tax system does not discriminate between foreign and domestic investors. The 2008 budget reformed the structure of the tax system (Legislative Decree No. 344/2003), reducing corporate income tax (IRES) rates by 5.5 nominal points from 33 to 27.5 percent, and trimming the regional business tax (IRAP) from 4.35 to 3.9 percent. These tax cuts are in response to increased EU-wide competition for investment, particularly as the enlargement of the

EU to 27 members ushered in various low cost, low tax East European states. Germany's 2007 decision to cut corporate tax rates by ten points rendered Italy's corporate tax rate the highest in the EU.

¶26. The GOI has tried to off-set the effect of corporate tax cuts on public revenue by introducing compensatory measures that keep effective rates of taxation high. They include:

-- setting new limits to the deductibility of interest;

-- abolishing accelerated depreciation; and

-- revising the tax treatment of consolidated reporting.

In addition, successive governments have sought to increase enforcement of existing tax laws.

RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT

¶27. There is no limitation in the Italian constitution or civil law on the right to private ownership and establishment of investments.

PROTECTION OF PROPERTY RIGHTS

¶28. Enforcement of Intellectual Property Rights (IPR) remains a serious problem in Italy. While anti-piracy and anti-counterfeiting laws on the books are widely regarded as adequate, relatively few IPR cases are brought to trial. Judges still regard IPR violations (and copyright violations in particular) as petty offences, and the magistracy is a weak link in combating piracy in Italy. The Italian Finance Police (GDF) and Italy's Customs Police are active in combating IPR theft; however they are frustrated that so few cases reach final sentencing. Italy remains on the Special 301 Watch List due to insufficient IPR enforcement and insufficient progress to combat Internet piracy.

¶29. Italy's restrictive interpretation of EU privacy laws now makes it virtually impossible for Internet copyright violation cases to be prosecuted. Currently there are no agreements between Internet Service Providers and rights holders on standard notice and take-down procedures.

¶30. Copyrighted works sold in Italy generally must bear a sticker issued by SIAE, Italy's royalty collection agency operating under authority from the Ministry of Culture (software purchased for business use is exempt). The music and film industries supported application of the sticker in the past, but are now dissatisfied with the system, asserting it has become overly burdensome while failing to provide adequate protection from piracy.

¶31. New initiatives on the part of the GOI to address the lack of IPR protection include:

- The Economic Development Ministry has created a General Directorate for Intellectual Property to take on functions previously shared between the Italian Patent and Trademark Office and the Anti-Counterfeiting High Commission.

- The Secretary General of the Prime Minister's Office will chair an inter-ministerial anti-piracy committee. The committee is charged with presenting a national anti-piracy action plan in early 2009.

- An economic development bill still under parliamentary review contains provisions aimed at facilitating investigations and increasing criminal penalties against trademark infringement.

It is too soon to determine the effectiveness of the above measures.

¶32. Italy is a member of the Paris Union International Convention for the Protection of Industrial Property (patents and trademarks) to which the United States and about 85 other countries adhere. U.S. citizens generally receive national treatment in acquiring and maintaining patent and trademark protection in Italy. After filing a patent application in the United States, a U.S. citizen is entitled to a 12-month period within which to file a corresponding application in Italy and receive rights of priority. Patents are granted for 20 years from the effective filing date of application and are transferable. U.S. authors can obtain copyright protection in Italy for their work first copyrighted in the United States,

merely by placing on the work, their name, date of first publication, and the symbol (c).

TRANSPARENCY OF THE REGULATORY SYSTEM

¶33. In an effort to improve accountability and competition in the wake of the 2003-04 collapse of the dairy firm Parmalat and the scandal which ensued, Italy's Parliament approved a law in December 2005 to overhaul the Bank of Italy (BOI) and improve corporate governance and oversight. The law also strengthened the powers of the Italian Companies and Stock Exchange Commission (CONSOB), the GOI's securities regulatory body, while reducing the BOI's scope in this area. Italy also is subject to single market directives mandated by the EU, which are intended to harmonize regulatory regimes among EU countries.

¶34. While such reforms are welcome, the average firm faces an uphill climb. According to a 2004 World Bank study, an entrepreneur wishing to start a business in Italy must follow 16 procedures, spend an average of 62 days, and pay around USD 5,000 in fees. Italian newspapers reported that in order to open a small business here (such as a wedding photography business) some 50 forms from more than 20 different government agencies need to be filled out. The study found that it costs more to open a business in Italy than anywhere else in Europe, with the exceptions of Greece and Austria. Government efforts to enable entrepreneurs to "open a business in a day" have not been successful.

EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT
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¶35. Financial resources flow relatively freely in Italian financial markets and capital is allocated mostly on market terms. Foreign participation in Italian capital markets is not restricted. While foreign investors may obtain capital in local markets and have access to a variety of credit instruments, access to equity capital is difficult. Italy has a relatively underdeveloped capital market and businesses have a long standing preference for credit financing. What little venture capital exists is provided by established commercial banks and a handful of venture capital funds. "Angel investing" has only begun to take root in 2008, after a brief existence snuffed out at the start of the century by the dot.com bust.

¶36. The Italian stock exchange ("Borsa Italiana") is relatively small -- fewer than 300 companies - and is an inadequate source of capital for most Italian firms. In 2007, the Borsa merged with the London Stock Exchange, raising expectations that governance standards and transparency of the Milan market would improve. Each of the partners will continue to be regulated by its respective national securities regulatory entity.

¶37. Financial services companies incorporated in another EU member state may offer investment services and products in Italy without establishing a local presence. U.S. and other firms based in non-EU member states may operate under authorization from CONSOB. In the wake of the global financial crisis and equity markets' losses, Italian policymakers and financial institutions have called for stricter regulation and supervision of financial institutions, as well as convergence and standardization of norms across the EU.

¶38. Most non-insurance investment products are marketed by banks, and tend to be debt instruments. Italian retail investors are conservative, valuing the safety of government bonds over most other investment vehicles. Only seven percent of Italian households own Italian company stocks directly. Of those who do own stocks, the weight of direct stock shareholding in their portfolios is only 22%. A few banks have established private banking divisions to cater to high net worth individuals with a broad array of investment choices, including equities and mutual funds. There are no restrictions on foreigners engaging in portfolio investment in Italy. Any Italian or foreign investor acquiring a stake in excess of two percent of a publicly traded Italian corporation must inform CONSOB, but does not require its approval. Any Italian or foreign investor seeking to increase its stake in an Italian bank above five percent must be authorized by the Bank of Italy.

¶39. Thanks to conservative lending practices and a lower degree of exposure to the instruments and markets most affected by the global financial turbulence, Italian banks have largely succeeded so far in

avoiding the worst of the current economic crisis. However, policymakers remain concerned about the banking sector's ability to maintain an adequate supply of financing to the economy in the ongoing economic downturn. The banking sector has undergone significant consolidation in the last decade, with about 60 percent of total Italian banking assets involved. Following the appointment in 2005 of Mario Draghi as Bank of Italy Governor, the process of consolidation picked up sharply. The top five banks' market share is larger than in Germany, but smaller than in France. Two major mergers in 2007 created Italy's two largest banking groups, Intesa-San Paolo, and Unicredit Group. The latter has become a major player in the European market, with recent acquisitions in western, central and eastern Europe. Another transaction between cooperative banks created Italy's fifth largest bank, Unione di Banche Italiane (UBI Banca), while the merger between Banco Popolare di Verona e Novara and Banca Popolare Italiana created Italy's largest cooperative banking group, Banco Popolare. In November 2007, Monte dei Paschi di Siena (MPS) bought Banca Antonveneta from Spain's Banco Santander. MPS was the last of the large Italian banks not to merge or be acquired. This purchase, in a rapidly consolidating market, made the Tuscan-based bank Italy's third largest lender with around 3,000 branches and a strong presence in the prosperous north-east of Italy. Currently, the country's largest banks are: Unicredit Group, Intesa San Paolo, Monte dei Paschi di Siena, Banco Popolare, and UBI Banca. The assets of Italy's five largest banks account for 53.5 percent of total banking assets.

¶40. Efficiencies obtained from mergers and from the entry of foreign banks are expected to have an impact on retail banking fees, currently among the highest in Europe. The Bank of Italy has urged Italian banks to become more competitive by cutting high transaction charges and to seek to merge among themselves to be more competitive against foreign banks.

¶41. Non-bank companies (either Italian or foreign) are not allowed to acquire more than 15 percent of a bank's capital, although emergency economic stimulus measures in late 2008 contemplated abolishing this restriction. Complex cross-shareholding has often been used to fight off takeover attempts in the financial sector. The presence of foreign intermediaries on the Italian market expanded in the last several years. In late 2005, the Dutch Bank ABN-AMRO obtained complete control of an Italian medium-sized bank, Banca Antonveneta, recently sold to Monte Dei Paschi di Siena. In May 2006, the French banking group BNP Paribas acquired full control of Banca Nazionale del Lavoro, one of Italy's primary banks. Credit Agricole acquired a controlling interest in Cassa di Risparmio di Firenze, di Parma e Piacenza and Banca Popolare Friuladria. No further significant acquisitions or mergers ocurred in 2008 as the industry digested the previous years' deals.

¶42. At end of 2007, 22 subsidiaries of foreign groups accounted for 11.2 percent of system assets, against 10 percent a year earlier. If the acquisision of Banca Antonveneta by MPA has already been completed, the share would fallen to 9.2 percent.

POLITICAL VIOLENCE

¶43. Political violence is not a threat to foreign investments in Italy, but corruption, and especially that associated with organized crime, can be a major hindrance, especially in the south - see next section.

CORRUPTION

¶44. Corruption and organized crime are significant impediments to investment and economic growth in Italy. Transparency International's (TI) Corruption Perceptions Index 2007 ranked Italy

55th out of 180 countries evaluated. Among EU states, only Greece, Lithuania, Poland, Romania and Bulgaria scored worse. Moreover, less than 30% of the population believes the government is effective in fighting corruption. In this survey Italians rated their Parliament and political parties as "very corrupt". TI's "Bribe Payer's Index" ranked Italy in the lower third of countries; in the same group as Saudi Arabia, Brazil and Malaysia. Among the countries of Western Europe, Italy came last. The NGO Global Integrity (GI) noted that Italy has very poor mechanisms to fight corruption in public administration and lacks effective law on conflict of interest. GI also found serious weaknesses in the protection of 'whistle-blowers' and in the regulations governing political party financing. Finally, the World Bank in its 2007 "Governance Matters" report

found Italy steadily deteriorating in its control of corruption. Among OECD countries only Mexico and Turkey had lower anti-corruption ratings from the World Bank.

¶45. Italy ratified the 1997 OECD Convention on Combating Bribery in September 2000. However, with the recent reorganization of the Corruption Commission, it is unclear whether Italy is able to prosecute the bribery of foreign officials, leaving it unable to fulfill its obligations under the convention. Although Italy has signed the United Nations Convention Against Corruption, as of January 2008 it has yet to ratify the document. Corruption is punishable under Italian law. As in all judicial processes, much discretion regarding punishment is left to the presiding judge. Most corruption in the recent past has involved government procurement or bribes to tax authorities. Bribes are not considered deductible business expenses under Italian tax law.

¶46. Organized crime is present throughout Italy, but is concentrated in four regions of the south (Sicily, Calabria, Campania, and Puglia). In November 2008, Confesercenti, the Italian confederation of trade, tourism, and service company operators released a report estimating that organized crime (Mafia, Camorra, 'Ndrangheta and Sacra Corona Unita) - is estimated to have a turnover of euros 130bn, with "commercial" activities accounting for euros 92bn, or 6 per cent of Italy's GDP. Organized crime is involved in racketeering, loan sharking, drug smuggling, and prostitution. Confesercenti estimates loan sharking accounts for euros 15bn of Mafia income. Narcotics are by far the most profitable activity, traded across Europe and worth euros 59bn. The report underscored recent warnings by anti-Mafia prosecutors that criminal gangs were expanding their activities into trade, tourism, the gaming industry, restaurants, construction, rubbish disposal and the property and health sectors. The report estimated that about 150,000 shopkeepers pay the pizzo, or protection money, to Mafia gangs, amounting to euros 6bn a year. For example, a stall in a food market in Naples has to pay euros 5 - 10 a day, while a Palermo construction site may hand over euros 10,000 a month. According to the press, loan-sharking seems to be increasing as banks have become more reluctant to lend in the current difficult economic environment.

¶47. Researchers estimate Italy's underground economy may be equivalent to between 20 and 27 percent of GDP. A great deal of economic activity is kept "underground" to avoid taxation.

BILATERAL INVESTMENT AGREEMENTS

¶48. As of December 2008, Italy has bilateral investment agreements with the following countries:

Albania
Algeria
Angola (signed, not enforced)
Argentina
Armenia
Azerbaijan
Bangladesh
Barbados

Belarus
Belize (signed, not enforced)
Bolivia
Bosnia and Herzegovina
Brazil (signed, not enforced)
Bulgaria
Cape Verde (signed, not enforced)
Chad
Chile
China
Colombia (signed, not enforced)
Congo
Cote d'Ivoire (signed, not enforced)
Croatia
Cuba
Czech Republic
Democratic Republic of Congo (signed, not enforced)
Dominican Republic (signed, not enforced)
Ecuador (signed, not enforced)
Egypt
Eritrea
Estonia
Ethiopia

Gabon
Georgia
Ghana (signed, not enforced)
Guatemala (signed, not enforced)
Guinea
Hong Kong, China
Hungary
India
Indonesia
Iran, Islamic Republic of
Jamaica
Jordan
Kazakhstan
Kenya
Korea, DPR of (signed, not enforced)
Korea, Republic of
Kuwait
Latvia
Lebanon
Libya
Lithuania
Macedonia, Republic of
Malawi (signed, not enforced)
Malaysia
Malta
Mauritania (signed, not enforced)
Mexico
Moldova, Republic of
Mongolia
Morocco
Mozambique
Nicaragua
Nigeria
Oman
Pakistan
Paraguay (signed, not enforced)
Peru
Philippines
Poland
Qatar
Romania
Russian Federation
Saudi Arabia
Slovakia
Slovenia
South Africa
Sri Lanka
Sudan (signed, not enforced)
Syrian Arab Republic
Tunisia
Turkey

Uganda
Ukraine
United Arab Emirates
Tanzania, United Republic of
Uruguay
Uzbekistan
Venezuela
Vietnam
Yemen (signed, not enforced)
Zambia (signed, not enforced)
Zimbabwe (signed, not enforced)

OPIC AND OTHER INVESTMENT INSURANCE PROGRAMS

¶49. The U.S. Overseas Private Investment Corporation (OPIC) does not operate in Italy, as it is a developed country. Italy's Export Credit Agency, SACE, is a member of the World Bank's Multilateral Investment Guarantee Agency (MIGA).

LABOR

¶50. Italy's unemployment rate, at 7.7 percent in December 2008 has begun to creep up as a decade of low growth and the slowing world economy begin to take their toll. This despite slightly liberalized temporary labor regulations and legalization of some underground employment. Traditional regional disparities remain unchanged, with the southern third of the country posting a significantly higher unemployment compared to northern and central Italy. Despite these differences, internal migration within Italy

remains modest, as industry and sector-wide national collective bargaining agreements irrationally set equal wages across the entire country. Labor shortages in the North are often filled by unskilled and semi-skilled immigrants from Eastern Europe and North Africa.

¶51. Italy's labor force is well-educated. According to a 2006 national survey, 9.7 percent of people aged 15 and older held university degrees and 42 percent completed upper secondary education. According to the OECD 2005 Economic Review of Italy, the private internal rate of return -- which measures incentives to invest in human capital -- is much lower for higher education than the OECD average, indicating there may be limited incentive for Italians to pursue higher education. This is due to the fact that persons with higher educations do not earn substantially more than persons with upper secondary educations. As a result, Italy has experienced a mild brain-drain among the highly-educated, entrepreneurial young. Firms interested in investing in Italy may have difficulties finding highly specialized young Italian employees.

¶52. On paper, companies may bring in a non-EU employee after the government-run employment office has certified that no qualified, unemployed Italian is available to fill the position. In reality, the cumbersome and lengthy process acts as a deterrent to foreign firms seeking to comply with the law. Work visas are subject to annual quotas, although intra-company transfers are exempt from quota limitations.

¶53. There are legal obstacles to hiring and firing workers although in recent years, the Italian labor market has become slightly more flexible. A series of legal reforms has encouraged the hiring of part-time employees by reducing employer social security contributions for these workers. New laws have also created opportunities for outsourcing, job-sharing, and use of private employment services. New types of contracts now exist that allow for reduced labor costs. However, high costs and legal obstacles associated with laying-off workers still remain a disincentive to adding permanent employees.

¶54. Italy is an International Labor Organization (ILO) member country. Terms and conditions of employment are periodically fixed

by collective labor agreements in different professions. Most Italian unions are grouped into four major national confederations: the General Italian Confederation of Labor (CGIL), the Italian Confederation of Workers' Unions (CISL), the Italian Union of Labor (UIL), and the General Union of Labor (UGL). The first three organizations are affiliated with the International Confederation of Free Trade Unions (ICFTU), while the UGL has been associated with the World Confederation of Labor (WCL). The confederations negotiate national level collective bargaining agreements with employer associations, which are binding on all employers in a sector or industry irrespective of geographical location.

FOREIGN TRADE ZONES/FREE PORTS

¶55. There are two free trade zones in Italy, located in Trieste and Venice, both in the northeast. Goods of foreign origin may be brought in without payment of taxes or duties, as long as the material is to be used in the production or assembly of a product that will be exported. The free-trade zone law also allows a company of any nationality to employ workers of the same nationality under that country's labor laws and social security systems.

Benefits of the free-trade zones include:

-- Customs duties deferred for 180 days from the time the goods leave the free trade zone to enter another EU country.

-- The goods may undergo transformation free of any customs restraints.

-- Absolute exemption from any duties on products coming from a third country.

U.S. Companies in Italy

¶56. The largest U.S. companies in Italy, based on number of employees, are: IBM, General Electric, Pfizer, Whirlpool, Electronic Data Systems (EDS), Accenture, Lear, and United Technologies.

FOREIGN DIRECT INVESTMENT STATISTICS

¶57. Italy lags behind many of its fellow EU member states in attracting and maintaining foreign investment. According to Bank of Italy figures, net foreign investment into Italy in 2007 totaled USD 32.3 billion (equal to 1.6 percent of GDP), well below its Euro zone counterparts. Notably, inflows were exceeded by outflows - USD 61.8 billion in 2007 (equal to three percent of GDP). This reflects a huge increase of out-bound investments in the energy sector.

Data on Italian Investment Inflows (direct and portfolio) is available at

http://www.unctad.org/en/docs/wir2006_en.pdf

or

http://www.bancaditalia.it/pubblicazioni/rela nn/rel07/ rel07it.

Table 1: Italian Foreign Direct Investment Inflows by Economic Sector (Net) 2004-2007 (USD Millions) (1) (*)

	2004	2005	2006	2007
Agriculture	234.8	511.8	-662.1	44.4
Energy	4463.3	10057.1	4104.3	4387.1

Industry of which:	2016.2	6996.3	7549.0	6629.0
Machine	3690.7	1314.3	4871.9	5201.6
Chemical	-3535.4	441.0	168.3	305.1
Food	362.7	2388.8	1839.2	-1033.6
Textiles	513.0	544.1	810.3	1289.0
Mineral/Metal	687.0	1315.5	143.2	289.0
Other	298.2	992.6	-283.9	577.0
Building and Public Works	125.7	205.0	283.9	239.3
Services of which:	9576.4	925.5	18639.5	20919.3
Banking/ Insurance	5749.1	1207.5	8810.3	7556.4
Trade	36.0	653.4	3570.4	2106.2
Transportation/ Communication	516.8	-11468.3	2027.6	5293.0
Other Services (Not For Sale)	3274.5	10532.9	4231.2	5963.7
T O T A L	16416.2	18695.7	29914.6	32319.1

Table 2: Italian Direct Investment Outflows by Economic Sector (Net) 2004-2007 (USD Millions) (1) (*)

	2004	2005	2006	2007
Agriculture	21.1	70.8	42.7	143.8
Energy	5336.7	2675.8	3775.1	37061.8
Industry of which:	7573.9	7629.8	13501.3	12364.3
Machine	4234.8	3684.5	9218.6	5922.0
Chemical	1730.4	1730.4	2267.6	2665.3
Food	151.6	206.2	623.1	657.3
Textiles	287.0	411.2	275.1	469.1
Mineral/Metal	246.0	600.0	-224.9	1610.2
Other	924.1	997.5	1341.8	1040.4
Building And Public Works	85.7	159.0	-113.1	114.2
Services of which:	5037.3	7444.7	16881.9	12106.2
Banking/ Insurance	2636.0	5164.6	10797.7	959.68
Trade	1060.9	923.0	1075.4	1426.08
Transportation/ Communication	-923.0	110.6	2069.1	1658.60

Other Services (Not For Sale)	2263.4	1264.6	2939.7	8061.83
T O T A L	18054.7	17980.1	34087.9	61790.3

Table 3a: Stock of Foreign Direct Investment in Italy by Major Investors; Year End 2004-2007 (USD Millions) (1)

	2004	2005	2006	2007
United States	22448.3	21451.0	25826.1	25581.3
EU (3) of which:	140651.5	145179.5	185773.4	238404.1
France	24608.6	25637.5	37040.8	44210.8
Netherlands	39009.4	40079.1	54304.3	72411.4
United Kingdom	26613.9	25434.5	30461.1	35584.2
Germany	14312.3	15309.3	11263.5	10959.0
Luxembourg	22336.5	24042.5	27911.7	31916.5

Sweden	3341.8	3034.2	3533.6	4203.5
Belgium	3335.1	1982.3	2353.1	7225.5
Spain	1941.0	4820.5	11764.2	18014.6
Other EU (4)	5286.9	4839.4	7141.0	13878.5
Switzerland	21872.7	20115.7	23446.6	26269.4
Liechtenstein	2105.9	1975.2	2330.7	2685.2
Japan	3595.2	3419.1	3967.1	4272.3
Argentina	257.4	246.8	288.5	329.4
Brazil	128.7	184.2	320.2	373.4
Other	9328.5	8747.3	10430.8	10781.8
T O T A L	200379.4	201318.8	252383.4	313767.2

Table 3b: Stock Of Foreign Direct Investment In Italy by Major Investors; Year End 2004-2007 (Percentage of Total)

	2004	2005	2006	2007
United States	11.2	10.7	10.2	9.4
EU	70.2	72.1	73.6	76.0
France	12.3	12.7	14.7	14.1
Netherlands	19.5	19.9	21.5	28.8
United Kingdom	13.3	12.6	12.1	11.3
Germany	7.1	7.6	4.5	3.5
Luxembourg	11.1	11.9	11.1	10.2
Sweden	1.7	1.5	1.4	1.3
Belgium	1.7	1.0	0.9	2.3
Spain	1.0	2.4	4.7	5.7
Other EU (3)	2.6	2.4	2.7	4.4
Switzerland	10.9	10.0	9.3	8.5
Liechtenstein	1.1	1.0	0.9	0.9
Japan	1.8	1.7	1.6	1.4
Argentina	0.1	0.1	0.1	0.1
Brazil	0.1	0.1	0.1	0.1
Other	4.6	4.3	4.2	3.4
T O T A L	100.0	100.0	100.0	100.0

Table 4a: Stock Of Italian Direct Investment Abroad by Major Recipient; Year End 2004-2007 (USD Millions) (2)

	2004	2005	2006	2007
United States	18851.2	19617.5	26118.6	27439.2
EU	182521.4	178145.2	217375.5	306708.6
Netherlands	63268.1	65081.5	89822.1	117453.9
Luxembourg	26363.3	25154.7	22632.4	26131.8
France	24344.5	23866.6	29574.4	35262.1
United Kingdom	24158.2	22617.5	24847.2	26086.4
Germany	15758.7	15004.7	18126.5	22153.7
Spain	10882.0	9866.6	12350.5	53197.7
Belgium	5308.3	4944.5	6254.3	7404.1
Sweden	866.3	892.6	1087.0	1149.3
Other EU (3)	11572.4	10716.6	12681.1	17869.7
Switzerland	10559.0	10007.1	11411.1	12838.9
Brazil	3954.4	4935.1	5645.6	7404.1
Argentina	2178.3	2211.3	2308.3	2298.7
Japan	1249.9	1164.1	1196.2	1320.6
Liechtenstein	194.4	175.9	200.3	222.5
Other	24901.6	26460.5	41685.1	47890.2
T O T A L	244410.2	243982.3	305940.7	407518.3

Table 4b: Stock of Italian Direct Investment Abroad by Major Recipient; Year End 2004-2007 (Percentage of Total)

	2004	2005	2006	2007

United States	7.7	8.0	8.5	6.7
EU	74.7	73.0	71.1	75.3
of which:				
Luxembourg	10.8	10.3	7.4	6.4
Netherlands	25.9	26.7	29.4	28.8
France	10.0	9.8	9.7	8.7
Germany	6.4	6.1	5.9	5.4
United Kingdom	9.9	9.3	8.1	6.4
Spain	4.5	4.0	4.0	13.1
Belgium	2.2	2.0	2.0	1.8
Sweden	0.4	0.4	0.4	0.3
Other EU (3)	4.7	4.4	4.2	4.4
Switzerland	4.3	4.1	3.7	3.2
Brazil	1.6	2.0	1.8	1.7
Argentina	0.9	0.9	0.8	0.6
Japan	0.5	0.5	0.4	0.3
Liechtenstein	0.1	0.1	0.1	0.1
Other	10.2	11.4	13.6	12.1
T O T A L	100.0	100.0	100.0	100.0

Table 5a: U.S. Investment in Italy by Economic Sector End-Year 2004-2007 (USD Millions) (2)

	2004	2005	2006	2007
Agriculture	40.2	41.3	46.1	52.7
Energy	627.6	576.2	678.5	803.8
Industry	13607.1	12958.7	15080.4	17692.5
of which:				
Machine	2979.7	2792.2	3205.5	4024.9
Transportation Equipment	902.5	830.0	971.0	1121.5
Chemical	3689.1	3447.5	4031.6	4642.8
Food	1920.3	2003.5	2321.5	2635.4
Textiles	273.6	260.9	304.3	355.8
Minerals/Metals	451.9	433.3	502.0	578.3
Other	3390.0	3191.3	3744.4	4333.8
Services	8173.4	7874.8	10021.1	11032.3
of which:				
Trade	987.0	933.9	1097.5	1259.2
Banking/ Insurance	4008.2	3771.0	4789.2	5386.5
Transportation/ Communication	666.5	636.4	1055.3	1199.1
Other Services	2511.7	2533.5	3079.1	3187.5
T O T A L	22448.3	21451.0	25826.1	29581.3

Table 5b: U.S. Investment in Italy by Economic Sector End-Year 2004-2007 (Percentage of Total)

	2004	2005	2006	2007
Agriculture	0.2	0.2	0.2	0.2
Energy	2.8	2.7	2.6	2.7
Industry	60.6	60.4	58.4	59.8
of which:				
Machine	13.3	13.0	12.4	13.6
Transportation Equipment	4.0	3.9	3.8	3.8
Chemical	16.4	16.1	15.6	15.7

Food	8.6	9.3	9.0	8.9

Textiles	1.2	1.2	1.2	1.2
Minerals/ Metals	2.0	2.0	1.9	2.0
Other	15.1	14.9	14.5	14.6
Services	36.4	36.7	38.8	37.3
of which:				
Trade	4.4	4.3	4.2	4.3
Banking/ Insurance	17.9	17.6	18.5	18.2
Transportation/ Communication	3.0	3.0	4.1	4.0
Other Services	11.1	11.8	12.0	10.8
T O T A L	100.0	100.0	100.0	100.0

Table 6a: Italian Investment in the U.S. by Economic Sector -- End-Year 2004-2007 (USD Millions) (2)

	2004	2005	2006	2007
Agriculture	52.3	62.6	71.1	71.7
Energy	1831.8	1877.2	2075.1	2079.1
Industry	7254.8	7589.1	13080.4	13516.8
of which:				
Machine	2777.2	2850.1	7910.4	8007.3
Transportation Equipment	950.8	966.9	1001.3	1045.4
Chemical	205.2	212.5	332.0	411.4
Food	273.6	289.3	304.3	320.6
Textiles	741.6	813.5	851.1	882.9
Minerals/ Metals	1589.1	1637.5	1724.6	1877.0
Other	717.3	819.4	956.7	972.2
Services	9719.6	10088.5	10892.0	11771.6
of which:				
Trade	1177.4	1201.9	1241.1	1276.7
Banking/ Insurance	4615.7	4796.9	5035.6	5612.0
Transportation/ Communication	232.0	242.0	278.0	329.4
Other	3694.5	3847.7	4337.3	4553.5
T O T A L	18858.5	19617.5	26118.6	27439.2

Table 6b: Italian Investment in the U.S. by Economic Sector -- End-Year 2004-2007 (Percentage of Total)

	2004	2005	2006	2007
Agriculture	0.3	0.3	0.3	0.3
Energy	9.9	9.6	7.9	7.9
Industry	38.3	38.7	50.1	50.1
of which:				
Machine	14.8	14.5	30.3	30.3
Transportation Equipment	4.7	4.9	3.8	3.8
Chemical	1.4	1.1	1.3	1.3
Food	1.4	1.5	1.2	1.2
Textiles	3.9	4.2	3.3	3.3
Minerals/ Metals	8.4	8.3	6.6	6.6
Other	3.7	4.2	3.6	3.6
Services	51.5	51.4	41.7	41.7
of which:				
Trade	6.2	6.1	4.8	4.7
Banking/				

Insurance	24.1	24.5	19.3	19.3
Transportation/ Communication	1.5	1.2	1.1	1.1
Other	19.7	19.6	16.5	16.6

T O T A L	100.0	100.0	100.0	100.0

Table 7: Direct Investment by Origin and Destination End-Year 2007 (USD Millions) (4)

	Foreign Investment in Italy	Italian Investment Abroad	Net Italian Position
EU	238404.1	306708.6	68304.5
of which:			
United Kingdom	35584.2	26086.4	-9497.8
Netherlands	72411.4	117453.9	45042.5
Germany	10959.0	22153.7	11194.7
France	44210.8	35262.1	-8948.7
Spain	18014.6	53197.7	35183.1
Luxembourg	31916.5	26131.8	-5784.7
Belgium	7225.5	7474.1	178.6
Sweden	4203.5	1149.3	-3054.2
Other (3)	13878.6	17869.5	3991.1
Non-EU	75363.1	100809.7	25446.6
of which:			
USA	29581.3	27439.2	2142.1
Switzerland	26269.4	12838.9	-13430.5
Liechtenstein	2685.2	222.5	-2462.7
Japan	4272.3	1320.6	-2951.7
Canada	1070.3	1695.5	625.2
Argentina	329.4	2298.7	1969.3
Brazil	373.4	7104.0	6730.6
Other	10781.8	47890.2	37108.3
T O T A L	313767.2	407518.3	93751.1

(1) Annual net investment flow data compiled by Embassy Economic Section, based on Bank of Italy data and converted at the following end-year exchange rates:

	2004	2005	2006	2007
Euro/Dollar	0.805	0.805	0.796	0.744

Net = New Investment Less Disinvestment. The volatility and huge changes from year to year in some sections can be explained in part by the fact that listed data are "Net": New Investment Minus Disinvestment.

(2) Compiled by the Economic Section of the Embassy based on Bank of Italy data and converted at the following end year exchange rates:

	2004	2005	2006	2007
Euro/Dollar	0.746	0.847	0.759	0.744

(3) Austria, Denmark, Finland, Portugal, Greece, Ireland (other EU 25 countries), plus Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia (plus Bulgaria and Romania only for 2007).

(4) Original data in euro and converted at the end-2007 exchange rate of one dollar = 0.683 euro.

Sources: Bank Of Italy Annual Report 2007
http://www.bancaditalia.it/pubblicazioni/rela nn/rel07/
rel07it.